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International Economic & Energy Weekly [redacted]

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15 November 1985

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15 November 1985

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International Economic & Energy Weekly

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15 **European Community: Pressures for Trade Protectionism Against LDCs**

The European Community, faced with persistently high unemployment at home and industry lobbying for more protection, is coming under increasing pressure to enact additional import barriers against LDC products. In the multilateral trade negotiations expected to begin in mid-1986 the Community probably will use current barriers and the threat of further protection as bargaining chips to open restricted LDC markets for EC exports and services. 25X1

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Perspective

China: Reaching Out [redacted]

As part of wide-ranging economic reforms since the late 1970s, China has become a more active international economic player, expanding its trade and investment linkages and participating more in international economic organizations. The past few years have seen many firsts for China: foreign loans, joint ventures, and enterprises wholly owned by foreigners. Beijing's plan for economic development for the rest of the century calls for even greater international involvement and the use of foreign technology, investment, and trade to help stimulate domestic economic growth. [redacted] 25X1

Over the past five years, the Chinese have undertaken several steps to increase foreign participation in their economy:
- Opened several cities to foreign investment, offering more liberal business terms than offered elsewhere in China.
- Passed laws governing taxation, liability, patent protection, trademarks, and investment procedures for foreign firms.
- Expanded the array of products of joint Chinese-foreign firms that may be marketed within China.
- Held many investment conferences to publicize hundreds of projects for which the Chinese want Western technology, equipment, capital, management, and marketing.
- Negotiated tax, investment, and other cooperation accords with several countries to clarify such issues as expropriation policy, arbitration procedures, repatriation of profits, and labor compensation. [redacted] 25X1

Beijing has tried to diversify its trade partners and its export product mix, but textiles, clothing, and petroleum continue to dominate its sales. Partly because of the weak oil markets and increasing protectionism against textiles in most developed nations, China has pressed harder over the past two years to develop new export markets. [redacted] 25X1

As China raises its profile in the global economy, it will generate frictions. Many of China's export products compete directly with those of other labor-intensive economies; if China displaces the exports of those suppliers, tensions will rise. For example, because China's oil price is lower than OPEC's, Indonesia has lost a share of its traditional oil market in Japan. China's desire to increase its participation in world economic organizations may also be viewed as potentially detrimental to smaller nations. The World Bank and the Asian Development Bank are cases in point: many countries worry that the Chinese demand for funds will squeeze smaller borrowers out. Nonetheless, Chinese participation in such organizations as GATT will enhance its image as a responsible trade partner and provide a forum to resolve multilaterally any trade problems. [redacted]

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At the same time, China is increasing its interaction with Eastern Europe and the Soviet Union. Because trade with the nonmarket economies is largely barter, China is able to conserve foreign exchange for purchases from Western suppliers. As part of a broader rapprochement, Beijing has signed long-term trade arrangements with the USSR and several East European nations. Despite some potential for increased trade and economic cooperation with these countries, they cannot supply the technology and equipment Beijing is seeking to modernize its economy or the hard currency markets needed to provide the earnings to pay for these imports. As a result, most of China's trade over the next five years will continue to be with Hong Kong and the OECD countries, perhaps with marked expansion of ties to the Pacific Basin.

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China and Mexico: Potential GATT Members

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A number of LDCs are exploring membership in the General Agreement on Tariffs and Trade (GATT)—accession negotiations would likely be part of a new round of multilateral trade negotiations expected to begin in mid-1986. Of the group, China and Mexico, the two largest nonmembers aside from the Soviet Union, would be the most important new members since Japan joined in 1955. While the size and market potential of these two countries would complicate accession negotiations, their addition could promote Mexican and Chinese trade liberalization.

Mexico and China: Major GATT-Member Trading Partners, 1984 *Percent*

Partner	Mexico	China [a]
United States	64.7	12.1
Japan	7.6	26.0
EC	11.2	10.4
Spain	5.5	NEGL
Singapore	NEGL	2.7
Canada	2.6	2.6
Brazil	2.2	NEGL

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[a] Hong Kong accounts for 18.5 percent of China's trade but is not a GATT member. It is represented in GATT by the United Kingdom. The United Kingdom on behalf of Hong Kong would have little leverage to demand concessions due to Hong Kong's lack of significant import barriers and the scheduled transfer of sovereignty in 1997.

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GATT Accession Procedures

Countries wanting to join GATT often conduct accession negotiations as part of a trade round. Candidates include China, Mexico, Morocco, Tunisia, Paraguay, and possibly Saudi Arabia. Potential members generally offer trade concessions to their major GATT-member trading partners [1] in return for benefiting from previous concessions exchanged among GATT members. In practice, and especially in the case of developing countries that receive special treatment under the GATT, the trade concessions on the part of the acceding countries have often been very small. Modest concessions probably would be demanded of the smaller developing countries that may also join before or during a new round. Accession of Mexico and China, however, will not be routine due to their market size, export potential, and, in the case of China, its nonmarket economy.

Mexico

GATT members, especially the United States, have repeatedly urged Mexico to join GATT. Mexico declined to become a charter member in 1947 in favor of retaining extensive trade protection. In 1980 Mexico negotiated an accession package, but the Mexican Cabinet rejected it due to opposition from manufacturers, unions, and the left. Last February government officials, including President de la Madrid, indicated that the government was again studying membership, but many observers predicted such a move only at a late stage of the government's new trade liberalization program.

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Developments since June indicate that there is much interest in the Mexican executive branch in joining GATT. In June, de la Madrid and Commerce Secretary Hernandez announced in Bonn that Mexico will participate in preparations for a new GATT round. Embassy sources report that in August Hernandez told members of the Mexican Congress that Mexico would be a GATT member by mid-1986 and would actively participate in the new round of trade negotiations. Mexican observers 25X1

[1] Countries seeking membership generally negotiate with their major GATT-member trading partners.

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at GATT are closely following new round developments and are analyzing the tariff structures of many GATT members, probably in anticipation of accession negotiations.

We believe Mexico is seeking to join GATT primarily to earn large amounts of foreign exchange for debt service. With a weak oil market, Mexico is exploring all avenues to improved export performance, including trade liberalization. In contrast to the pressures on Mexico City by international financial institutions to liberalize trade unilaterally, participation in GATT negotiations would move the debate to a multilateral forum where Mexico can receive trade concessions for its efforts. Also, joining GATT could be held out as a gesture to improve trade relations with the United States and would open a new forum in which to promote Mexican access to the US market.

Although some top Mexican officials are pushing GATT entry, we believe the government as a whole, as well as affected interest groups, probably are just as opposed to entry as they were in 1980. We expect Mexico's highly protected industry again to lead the opposition. In light of his low level of support from the private sector, we believe de la Madrid and other pro-GATT officials are concerned about being embarassed as they were in 1980. At that time Hernandez was chief negotiator for the accession package, and de la Madrid, then planning secretary, is reported to have voted in favor of membership. They are trying to win over opponents but could be forced to reconsider membership at the last minute.

Industrial country GATT members probably will request substantial concessions, primarily on tariffs, and perhaps will demand trade liberalization commensurate with Mexico's role as a newly industrializing country. Mexico probably would reply that, because the GATT grants special treatment to LDCs, Mexico should not be required to give up infant industry protection. It would also probably attempt to have its July 1985 plan to replace import licenses with tariffs and its April 1985 agreement with the United States to phase out export subsidies counted as part of any accession package.

The key question for GATT members is whether de la Madrid will be able to sell an accession package brought back from Geneva. Mexican negotiators may point to domestic opposition to GATT entry in an effort to obtain lenient terms from the United States and other trading partners. According to US officials, Mexico probably will also propose that results of its 1980 accession negotiations be adopted, instead of conducting new negotiations. Its major trading partners, however, are virtually certain to seek more extensive concessions based on the assumption that Mexico's ability to compete in world manufactured goods markets has improved since 1980.

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A replay of Mexico's experience in the Tokyo Round is also possible. Mexico participated actively in discussions on nontariff barrier codes, GATT reform, and tariffs. Mexican political leadership lobbied internally for joining GATT. In the end, however, Mexico backed off and "pocketed" concessions made by the United States bilaterally.

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China

We believe China is interested in participating in the new round and is investigating the benefits of membership in GATT. It initially considered membership in 1981, but first opted to join the Multifiber Arrangement (MFA) under the GATT in January 1984. China became an observer in GATT in November 1984. At last month's special GATT Contracting Parties' meeting, Chinese officials privately sounded out major trading partners on accession, according to Embassy reports.

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A potentially thorny issue is whether China should be considered a new member. Careful crafting of Beijing's 1984 request for observer status avoided prejudicing its claim to the old "China seat" vacated by the nationalist government in 1950; Taiwan reaffiliated with GATT in 1965 as an observer but was removed in 1971 when China became a UN member. Last month in informal discussions with US officials, Chinese trade officials asserted that the China seat formula is the

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only acceptable means of accession but also noted that they are otherwise willing to enter into accession negotiations on tariff concessions and take on other obligations consistent with China's status as a developing country. Despite these assurances, it is still possible that Beijing may argue that, as an old member reassuming its seat, it should make smaller initial concessions. The United States has reserved its position on the China seat issue.

In pursuing GATT membership, we believe Beijing is primarily interested in greater access to Western markets. As a GATT member it would be:

- Better positioned to watch over its interests in maintaining industrial country market access.

- Closer to obtaining preferential tariff treatment (GSP) from the United States—GATT membership fulfills one of the conditions required by US law to make a Communist country eligible. Membership would also allow Beijing to exercise political influence as an LDC leader in a new forum.

On the other hand, Beijing probably feels no urgency to join GATT. Textiles and clothing are currently the most important Chinese exports and are regulated by the MFA, which China has already joined. To protect its textile interests, China would not need to join GATT unless the MFA is folded back into GATT, which is improbable before the 1990s. However, agreement on the future handling of textiles in GATT could be reached during a new GATT round, and China probably would want to participate in such deliberations.

The Problem of China's Nonmarket Economy

Industrial country officials worry whether GATT rules—not designed to deal with nonmarket economies (NMEs)—can integrate a large NME such as China into the world trading system. Although many GATT members are also wary of China's potential to greatly expand exports, we believe they would not oppose Chinese membership for this reason.

The key question is whether Beijing's tariff regime is a sufficient base for productive accession negotiations. According to US officials, Chinese officials argue that in the future Beijing will rely mainly on "economic measures," such as tariffs, exchange rates, and bank credit, to regulate foreign trade. We believe there is truth to Beijing's claim that import duties have a function in the Chinese economy. Since 1979 China has sharply reduced tight 25X1 central control over foreign trade—currently about 40 percent of foreign trade decisions are being made by independent enterprises. Because these enterprises are largely responsible for their own profits and losses, tariffs affect costs and, therefore, decisions to import. 25X1

It is unclear, however, how the Chinese would react to the alternative types of trade concessions that it might be asked to offer in combination with tariff cuts:

- ***Import Commitments.*** When Poland and Romania joined, their GATT-member trading partners felt tariff cutting would be pointless because 25X1 imports, prices, and foreign exchange allocation are centrally controlled. Instead, they demanded pledges of increased shares of imports from GATT members. Such a commitment would serve little purpose in China's case because its trade share with GATT members is already high—94 percent in 1983.

- ***Market Disruption Agreement.*** The Hungarian, Polish, and Romanian accession protocols contain market disruption mechanisms that go beyond GATT rules in providing safeguards to other members. We believe China will fight a tough 25X1 market disruption commitment—Beijing was so displeased with the US textile market disruption criteria announced in December 1983 that it refused to acknowledge their validity—but industrial countries are certain to demand some commitment due to China's huge export potential.

- ***NTB Codes.*** China could be asked to sign some of the Tokyo Round nontariff barrier codes. We believe Beijing would seriously consider signing the technical codes on licensing, customs proce-

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dures, and standards but probably would balk at other codes, such as subsidies.

- ***Hong Kong.*** Beijing might be asked to grant Hong Kong autonomy in foreign trade and allow it to become a full GATT member, but we believe Beijing probably would refuse to involve Hong Kong in accession talks.

- ***Supply of Trade-Related Data.*** GATT members might ask China to provide breakdowns of tariff revenue, subsidies, or trade conducted by independent enterprises, as well as information on prices, costs, and market opportunities. This could be used to monitor the development of market mechanisms in China and promote trade between China and GATT members. Beijing supplies large amounts of financial data to the IMF and may agree to provide much production and trade data to the GATT Secretariat. [redacted] 25X1

Outlook

Overall, whether Mexico or China will join GATT is a close call. While we believe there is some support in both countries to participate in a new GATT round as a way to open industrial country markets, both countries can get along well without being GATT members. Because of this, both will be hard bargainers, and the major trading partners have no guarantee of obtaining the market opening concessions they desire. In particular, US interest in tariff cuts on high-technology products or better access for service industries might be thwarted.

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The Tin Market Collapse: Update and Fallout

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The tin crisis will not be resolved soon. Nearly all trading has been halted since the International Tin Council announced on 24 October that it could no longer support prices, and reports of unofficial trading indicate prices are about 20 percent below the precrisis level. We believe the Council will soon begin to default on its large debts to traders, causing solvency problems for several banks and London Metals Exchange (LME) traders. Moreover, we foresee several years of low tin prices that will cause economic and political problems for several tin-producing countries.

The Role of the International Tin Council

The tin market collapsed because of actions by the International Tin Council—a 22-member organization of producer and consumer countries, which has been in operation since 1956 to stabilize world tin prices. Because of increasing output by nonmembers and continuing weak demand, the Council in recent years has had to support prices by limiting tin exports from member countries and by purchasing tin on the open market. Because tin on the LME is priced in sterling, the weakness of the pound over the last several years has helped buoy tin prices. As the pound began to rise earlier this year, however, tin prices began to fall. As a result of heavy buying and borrowing by the Council bufferstock manager, Council support funds were rapidly depleted. Finally, in late summer the Council's credit started to dry up and the Council turned to the Association of Tin-Producing Countries (ATPC)—an independent, seven member, research and marketing group—for financial help. The ATPC promised to ante up an additional $60 million but by late October failed to deliver. On 24 October an emergency meeting of the Council in London failed to solve the liquidity problem. Within minutes after the meeting, the price of tin on the LME plummeted.

The Current Market Situation

Tin trading has been suspended on the LME and the Kuala Lumpur market—the only major tin exchanges—since the crisis began on 24 October. To put pressure on the Council, banks, and creditors to solve the crisis, the LME has announced it will resume tin trading on Monday. Press reports indicate some off-market, unofficial tin trading is occuring at prices of $8,400 to $9,900 per metric ton—roughly 20 to 30 percent below the precollapse LME price. The lack of organized markets for tin has caused many mines in Thailand and Malaysia to begin closing. 25X1

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Uncertainty about the tin market has affected trading in other metals as well. Copper prices fell 10 percent in the first week of the tin crisis, while aluminum, lead, nickel, and zinc prices fell 5 to 10 percent because of large-scale dumping of these metals by LME traders trying to accumulate cash to cover their possible tin losses. The weakened confidence in the LME by world metals traders has caused trading volumes to be slashed—copper trading fell 60 percent—and some large mining companies have quit using LME prices to set their own selling prices.

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The Financial Fallout

The financial impact produced by the tin market collapse is aggravated by the complexities of the tin market's financial linkages:

- The Council financed its bufferstock purchases with contributions from its members and by borrowing. The bufferstock owned 52,500 tons of tin valued at $700 million just prior to the crisis, and owed $490 million to banks. The banks and traders are holding the Council's tin as collateral. With a 20-percent price drop, for example, the value of the tin would barely exceed the value of the loans.

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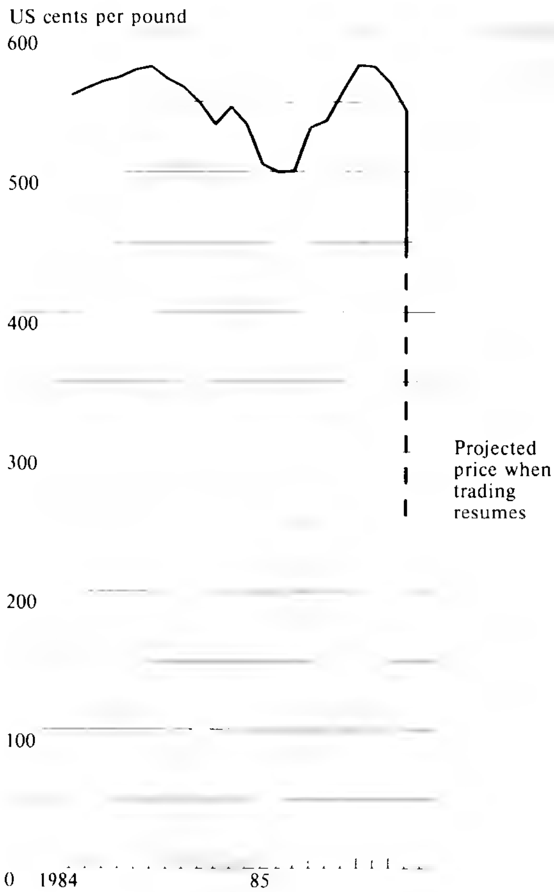
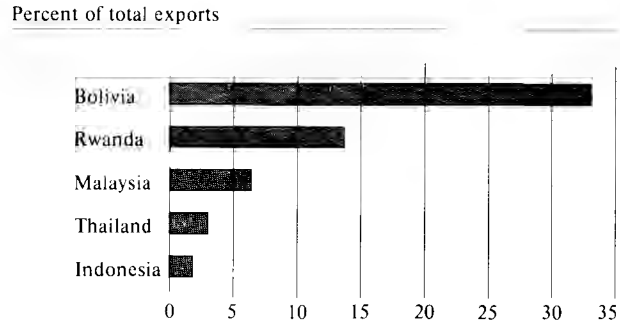
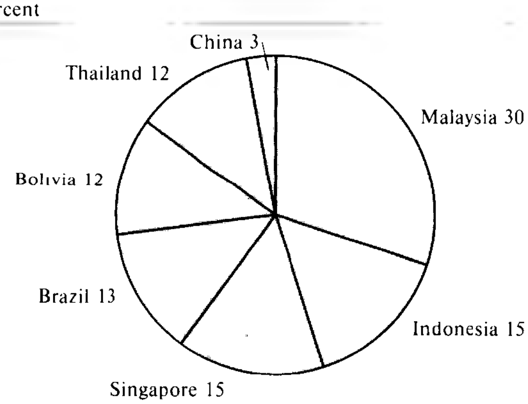
LME Tin Prices, January 1984-October 1985



LDC Dependence in Tin Exports, 1982



Share of World Tin Export Market



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- The bufferstock manager had committed the Council to purchase 61,000 tons of tin over the next three months at an average price of 8,900 pounds sterling per ton—a commitment of roughtly $770 million at current exchange rates. The Council, however, has the option to pay the sellers the difference between the contract price, and the prevailing market price at the time the contract must be executed—the so-called broker differential. The lower the tin price, therefore, the more the Council owes traders. Moreover, because the value of the bank's tin collateral has fallen, the Council now has "residual debt" to its creditors—debt that the collateral no longer covers—which also rises as the price of tin falls. According to Tin Council estimates, a 30-percent drop from the 24 October price would produce a residual debt of over $300 million. 25X1

The legal obligations of the players is unclear. The agreement that allows the Council to operate in London subjects the Council to British law—meaning banks and traders could sue the Council. Most of the Council member governments do not consider themselves liable, however. 25X1

Council Likely to Default

There have been no solid rescue plans put forth to resume tin trading and solve the Council's debt problem. Both Britain and the banks proposed that the Council's member governments repay the outstanding debts and slowly reduce the tin bufferstock. In return, the banks have offered to postpone any interest or principal payments for one year. As in most commodity-trading industries, there are many rumors about other possible proposals, but we put little weight in these. Reporting from a wide variety of sources indicates there will be little money forthcoming from the Council members. [redacted]

As a result, we believe the Council will ultimately default on its debts to traders and banks in a matter of months. These creditors will then be forced to liquidate their tin collateral—probably causing a 30- to 50-percent collapse in tin prices from their precrisis levels. The current efforts by the banks to seek cooperation from the Council members may shift, however, to an effort to collaborate with the LME traders—who also control large quantities of tin—to bring down the price of tin slowly and perhaps sue the Council governments to recoup their losses. There are press reports that the British Government could bail out some creditors who have heavy exposure to the Council. [redacted]

Because the Council members' unwillingness to cooperate in a rescue effort probably is not fully appreciated by the creditors, negotiations are likely to continue for a few more weeks. There is an outside chance that the creditors could persuade the Council to make some concessions in this period. Time is against them, however. The legal ambiguities, the amount of money involved, the usual problems of negotiations, and the slowness of consultations with the respective home capitals will combine to bog down any resolution process. [redacted]

Country Impacts

Overall, the drop in tin prices is another blow to LDC commodity exporters already battered by debt and earnings problems. [redacted]

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[redacted] The drop in tin prices will not affect all producers equally, however: 25X1

- Bolivia, which depends on tin sales for roughly a third of its export earnings, will be hard hit. As a result of the price collapse and lower production, annual tin earnings could drop by $100 million. According to the US Embassy, most private mines will close—adding 40,000 to the total unemployed. This will increase the leftist threat to the new government. The price drop may, however, provide a scapegoat for the president's already-formulated plans to slash employment in the public mining sector. As a result, Bolivia has approached the IMF for compensatory financing. 25X1

- Malaysia should be in a good position to weather the transition. Because of existing export quotas, many inefficient operations have already been trimmed. [redacted] 25X1 only 22 of the 400 mines could survive a 50-percent drop in tin prices—throwing 17,000 out of work. Because tin accounted for only 3 percent of total export revenues in 1984, this will not pose a serious economic problem, but the political risks may be considerably steeper. Most of the small producers who are likely to fail are ethnic Chinese—politically important to the current government. 25X1 25X1

- Indonesia, which together with Malaysia ranks as the world's most efficient tin producer, also should fair reasonably well. Over the last few years, Indonesia has followed a policy of phasing out its smaller, older, and less efficient land-based dredges in favor of new, large capacity, offshore dredges. As a result, since 1980 the number of onshore dredges has declined from 19 to 10 with the process being accelerated by tin export controls.

- Thailand, which earned nearly $200 million from tin sales in 1984, has begun shutting down many of its mines, according to a recent Embassy report. In the longer run, however, mine owners believe that Thailand can recover more quickly

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than its competitors because of low labor costs and high-grade ore. The widespread smuggling of Thai tin is likely to cease, however.

- Brazil, which has tripled tin production to 21,000 tons since 1980, will also feel the effects of lower prices. Brazil, however, is still expanding its tin exports—mainly to the United States—and may be able to offset lower prices with increased export volume.

- China is the large unknown in the export equation. It has doubled tin exports in the first half of 1985 over the same period last year. Most observers believe the Chinese will continue to boost exports even in the face of lower prices because of its hard currency needs. (

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Britain, which has expanded tin production in recent years, could find the going tough for its industry because of its high cost production. This could further worsen the unemployment problems in the mining regions. Canada, which recently placed in operation the East Kemptville open pit mine, will consume most, if not all, of the tin it produces and thereby will be isolated to a large extent from price changes.

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Pakistan: High Hopes for US Aid [redacted]

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Pakistan hopes to secure an unprecedented six-year $6.5 billion military and economic aid package at next week's consultative group meeting with the United States. Despite an improved economic performance this year, Pakistan wants a large aid package, in part, to cushion against expected future downturns. Islamabad, in particular, anticipates a continued decline in remittances as job opportunities in the oil-producing states dwindle. Nonetheless, they probably will hold out against many of the economic reforms the United States and the IMF are advocating. Any US aid package below the previous $3.2 billion level will be seen by Islamabad as a lack of US commitment to Pakistan and a result of Indian pressure. It will also provide ammunition to those in Pakistan who question the wisdom of close ties to Washington. We judge Islamabad would accept a US aid package in the $3-4 billion range that is weighted toward economic assistance and contains highly concessional military aid. [redacted]

Wish List

Pakistan has requested a more than doubling of the level of US assistance in the second multiyear aid package. Compared with the $1.6 billion each for economic and military aid in the first package (FY 1981/87),[1] Islamabad wants some $3.9 billion in economic aid and $2.6 billion in military assistance for FY 1988/93. [redacted]

Islamabad claims that it needs increased economic aid to sustain economic growth, avoid foreign financial problems, and maintain political stability during a transition to a more representative form of government. It wants the economic aid divided between quickly disbursed PL 480 assistance—to bolster Pakistan's foreign payments position—and grants and soft loans for energy, agriculture, and irrigation projects. [redacted] 25X1

Pakistan's defense assistance requests have varied from a high of $3.4 billion to the most recent $2.6 billion, according to the US Embassy and press reports. The current request encompasses increased air defense systems, armor, naval surveillance equipment, and enhanced domestic defense production. [redacted]

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Economic Backdrop

Islamabad's request for increased aid comes during a temporary respite from foreign payments problems that have been aggravated by rapid economic growth. Over the past seven years, Pakistan's economy has grown by an average of more than 6 percent annually in real terms, and we estimate a record 8.4-percent growth rate in FY 1985. [redacted] 25X1

Reserves had been as high as $2 billion in late 1983, but, in FY 1984, faced with a disastrous cotton crop, a steady decline in worker remittances, and a reluctance to institute politically unpopular import and spending cuts, Pakistan drained its foreign exchange reserves to "buy" economic stability and modernize the military. Also, increased debt service payments in recent years have added to the precarious financial position. [redacted] 25X1

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Fortuitous economic circumstances and creative financial maneuvering have more than doubled foreign exchange reserves since mid-August to $750 million, and also financed the public deficit: 25X1

- Export earnings—primarily raw cotton and cotton-based manufactures—increased more than 28 percent, while imports dropped 7 percent in

[1] The Pakistani request is based on its fiscal year, which runs from 1 July to 30 June. The first package was based on the US fiscal year—the economic portion was for six years and the military portion for five. [redacted]

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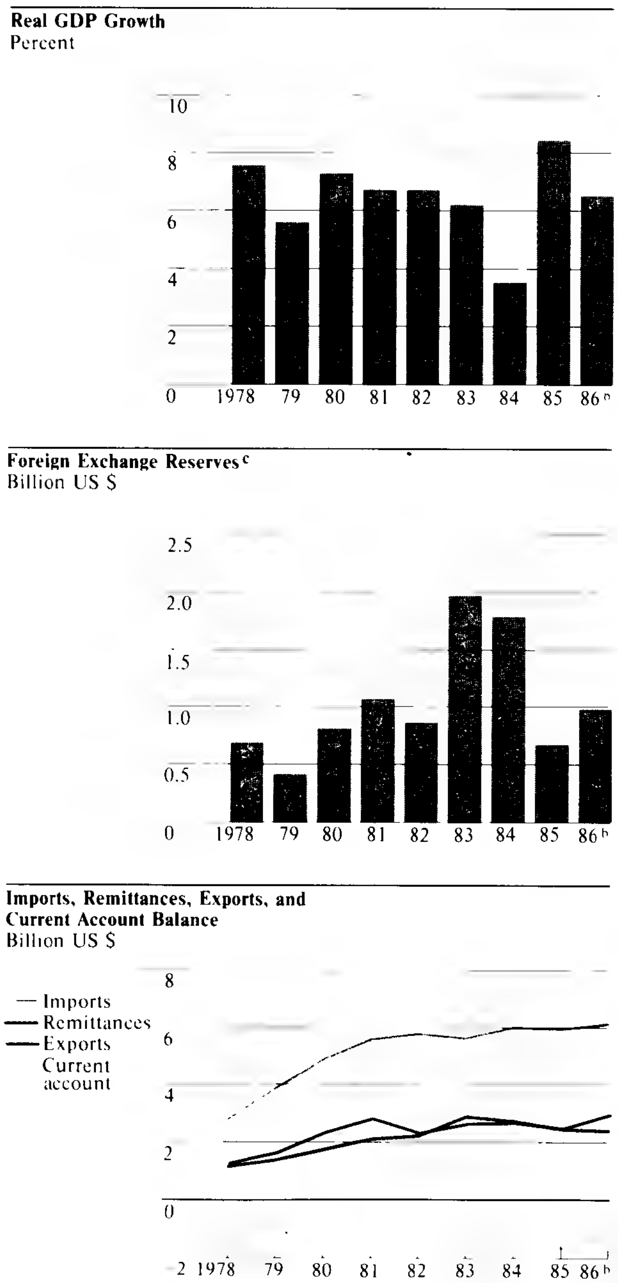
Pakistan: Economic Indicators[a], 1978-86



[a] Fiscal year ending June 30
[b] Estimated
[c] Position as of June 30

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value terms in the first quarter of FY 1986, according to US Embassy reporting.

- A lower US dollar has stimulated remittance earnings—September totals were 16 percent higher than the same month last year.
- Sales of Special National Fund Bonds (SNFBs) designed to tap the nation's vast reserves of "black money"—estimates vary from 20 to 50 percent of GDP—have netted over $1 billion, more than five times the expected amount.
- New high-interest foreign exchange bearer certificates (FEBCs) have attracted more than $52 million—mostly from expatriates—since August, adding to Pakistan's reserves.

We believe that foreign exchange reserves probably are sufficient to cover about two months of imports, enabling Pakistan to forgo an IMF loan for awhile.

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Outlook

The improvement in Pakistan's domestic finances and foreign payments position is likely to provide Islamabad only temporary relief from longstanding economic problems. The boost in export earnings was largely in highly competitive areas—such as textiles and cotton—that are dependent on import quotas and volatile world commodity prices. The new bond schemes will provide only short-term help and add to inflationary pressures because they allow the government to cover the budget deficit by borrowing heavily from the domestic banking system. The high-interest FEBCs may well raise the country's debt service burden and increase the opportunity for capital flight, if purchasers decide to claim their interest or cash in their certificates during periods of economic or political instability. Moreover, nearly $200 million in US Foreign Military Sales repayments are due this fiscal year, and we estimate that at least 25 percent of earnings from exports of goods and services will be required to meet growing debt service payments. Also,

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strong economic growth is likely to increase import demand while remittance levels decline and the prospects for export growth are uncertain. [redacted] 25X1

Citing political difficulties, the Zia regime is reluctant to institute economic reforms recommended by the United States and multinational lenders. Since FY 1981, Islamabad has been unwilling to slash spending, reduce subsidies, or raise taxes to control the deficit. Pakistan has strongly resisted IMF recommendations to narrow the trade deficit by currency devaluation but has been more willing to discuss deregulation and an increased role for the private sector in the economy. [redacted] 25X1

Implications for the United States

We believe Islamabad took into account its perception of Pakistan's strategic importance to Washington and its calculations of the severity of financial problems down the road when it proposed the $6.5 billion figure. At the same time, Pakistan, in our view, is well aware of the fiscal and political difficulties involved in securing such a large package from Washington. While we have no indication of a fallback position, we believe Islamabad is prepared to accept something close to $3-4 billion, with a higher proportion of economic aid. Still, we believe that Pakistan will insist on expensive air defense systems and military aid on highly concessional terms. [redacted] 25X1

We view Islamabad's public disclosure of the $6.5 billion aid request as a means to lay the blame on the United States if lower assistance requires unpopular austerity measures. A cut in US aid from current levels probably would result in charges that the US commitment to Pakistan has been reduced in an effort to woo India. This would also give Islamabad an excuse to reduce its assistance to the Afghan refugees and provide additional ammunition to those who are wary of Pakistan's close ties to the United States. [redacted] 25X1

[redacted]

European Community: Pressures for Trade Protectionism Against LDCs

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The European Community, faced with persistently high unemployment at home and industry lobbying for more protection, is coming under increasing pressure to enact additional import barriers against increasingly competitive LDC products. The newly industrializing countries (NICs),[1] whose high quality, low-cost products are taking growing shares in an increasing number of EC import markets, are the primary targets. Already in effect are import restrictions against such products as steel, textiles, and video recorders; the next trouble area is likely to be high technology. In the multilateral trade negotiations expected to begin in mid-1986 the Community probably will use current barriers and the threat of further protection as bargaining chips to open restricted LDC markets for EC exports and services.

Recent Trends

Developing countries, especially the NICs, have been diversifying their exports and moving into markets that directly challenge the West Europeans. In 1975 manufactures accounted for 26 percent of EC nonenergy imports from LDCs compared with 42 percent for foodstuffs. Last year the share of manufactures reached 41 percent while that of foodstuffs slipped to 35 percent. Much of the increase came from the NICs, who boosted their share of EC imports of LDC manufactures from 56 to 67 percent over the period. The NICs have made their greatest inroads in such products as toys, watches, and consumer electronics, taking full advantage of their lower labor costs.

Restrictive Measures

EC manufacturers view the NICs as a major problem because they have successfully penetrated traditional industry markets—despite the presence of import barriers—and are becoming a threat in other selected areas, petrochemicals, and video cassette recorders (VCRs), for example. Most restrictions take the form of voluntary restraint agreements (VRAs), but quotas and tariffs are also used.

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Textiles. The EC limits imports of textiles from LDCs through the Multifiber Arrangement (MFA), as well as through voluntary agreement by exporters. As a result of protection and modernization, EC textile firms in West Germany, France, and Italy are regaining market shares—the LDC import share of the EC clothing market has dropped slightly since 1981. New VRAs on textiles and clothing exports from Morocco and Tunisia were negotiated earlier this year. 25X1

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Steel. The EC maintains stringent trade restrictions on all imported steel, relying primarily on annually negotiated VRAs with foreign suppliers. Limits have been tightened on its two major LDC suppliers, South Korea and Brazil. This year South Korean steel is limited to 205,700 metric tons and Brazilian imports to 150,000 tons, compared with 1984 levels of 200,000 and 210,000 tons, respectively.

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Petrochemicals. Imports from the Gulf Cooperation Council (GCC) nations—Saudi Arabia, Kuwait, Qatar, Bahrain, Oman, and the United Arab Emirates—have grown rapidly and now account for roughly 5 percent of the EC's petrochemical market, up from zero in 1983. Modern Saudi petrochemical plants are far more efficient than EC plants, and the GCC nations in general are now moving away from basic petrochemicals into the more advanced products the EC produces. Last June, the EC Commission elected to maintain a previously imposed 13.4-percent duty on Middle East exports of linear low-density polyethylene and methanol. In spite of this, many EC firms, currently operating at the break-even point, are likely to 25X1

[1] In this article, we have defined the NICs as South Korea, Singapore, Hong Kong, Taiwan, Mexico, and Brazil.

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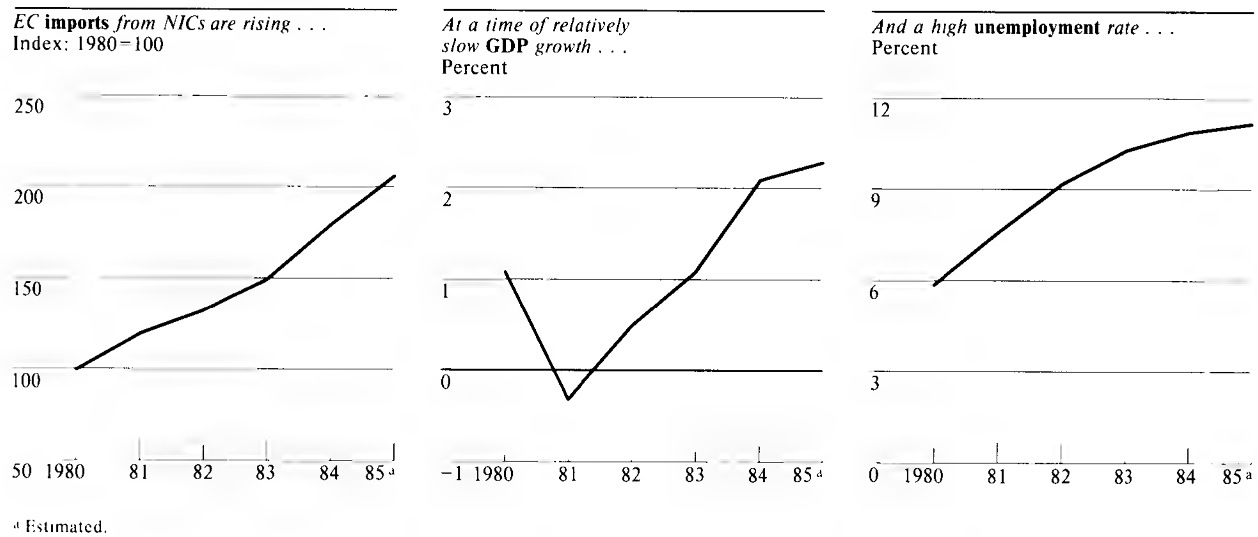
European Community: Economic Indicators, 1980-85



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have to reduce capacity further and face losses or shutdown. Petrochemical products from modern complexes in East Asia, Mexico, and Brazil are also hurting EC firms.

Consumer Goods. Trade restrictions have been imposed on VCRs and quartz watches in recent months as the EC attempts to stem the tide of NIC imports. Last July the Community raised the tariff rate on imported VCRs from 8 to 14 percent. Directed primarily at Japan's 90-percent share of the EC VCR market, the move will hurt South Korea more because Japanese producers have established assembly operations within the EC. During the same month, the EC imposed quotas on indirect imports of quartz watches from Japan, China, and Taiwan, which effectively prohibit any further imports for the remainder of 1985. Earlier in the year France—after receiving EC authorization—restricted its imports of digital watches from Hong Kong, Macao, South Korea, and Taiwan for the next three years.

Prospects

The next major contentious issue between the EC and the LDCs will likely be high-technology imports, which include microelectronics, telecommunications, and informatics. South Korea is producing computer chips and targeting research and development projects in advanced semiconductors, office automation systems, and telecommunications equipment. Taiwan and Brazil also regard semiconductor production as a priority program. The EC is investing heavily in R&D programs in high-technology industries, counting on them to stimulate economic growth and to help close the technology gap separating Western Europe from the United States and Japan. As a result, the Community—led by France—is moving carefully on high technology in the new GATT round and prefers at this point to keep specific references to high tech out of the negotiations, thereby enabling it to better control access to Community markets.

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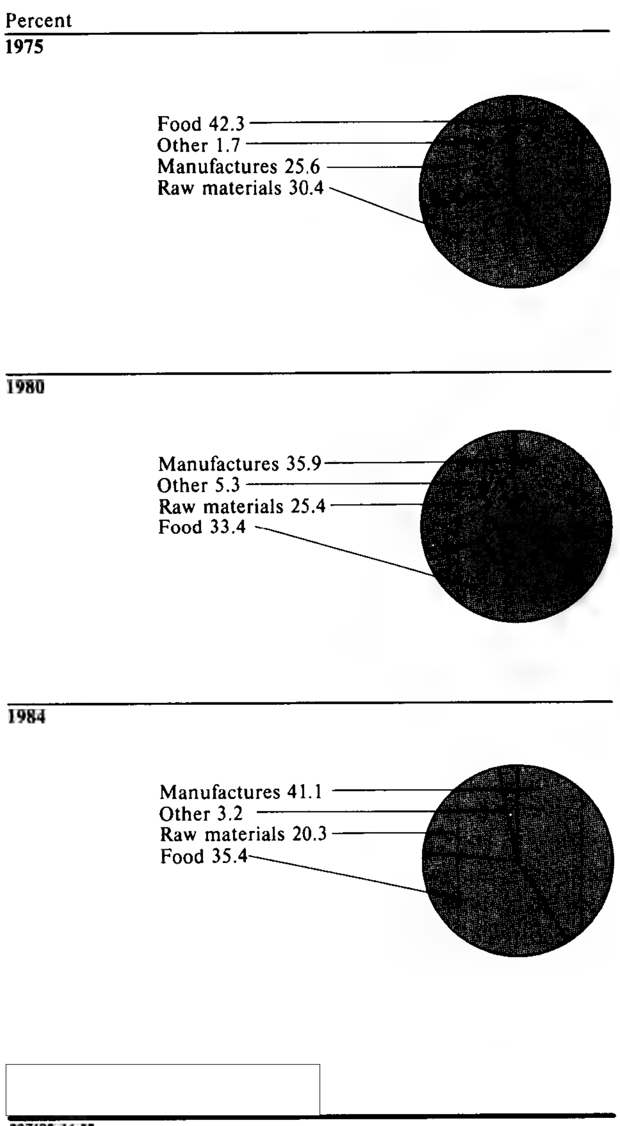
European Community: Nonenergy Imports From LDCs, by Category



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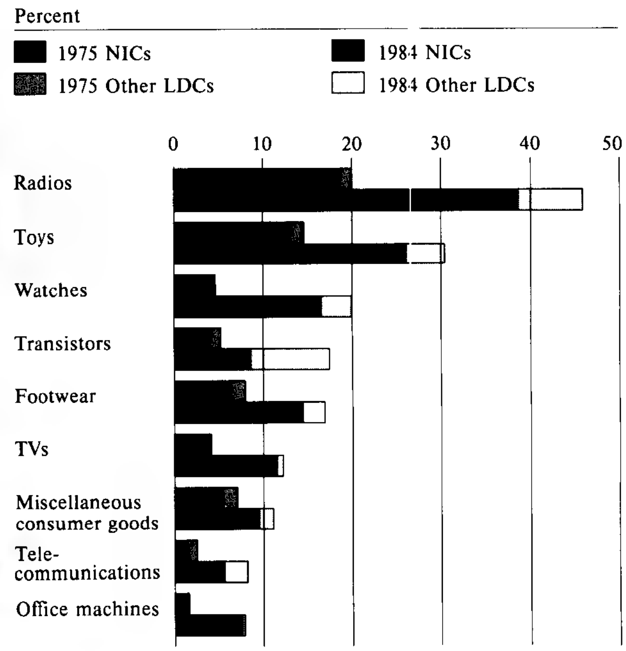
European Community: LDC Share of Selected Imports, 1975 and 1984



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The EC is presently undertaking a midterm review of its Generalized System of Preferences (GSP) and is likely to limit preferences for the advanced LDCs. Other EC preferential trade arrangements with LDCs, however, would not be affected. The Community's GSP, renewed unilaterally in 1981 for 10 years, offers LDCs duty-free access for most industrial products (with exceptions for sensitive items) and for more than 20 percent of agricultural products; the remaining agricultural products come in at reduced tariffs. Once imports reach a specified level, however, customs duties are imposed. Under an EC Commission proposal, exclusions from preferences would be enacted for products from countries that have achieved a 20-percent share of EC imports of the respective products. Should the EC Council approve the Commission's

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European Community:
Preferential Trade Agreements With LDCs

	Countries Covered	Provisions
Lome Convention III	66 African, Caribbean, and Pacific (ACP) countries	Nonreciprocal duty-free access to EC markets for all raw materials and industrial goods and 96 percent of agricultural goods. (Rice, corn, and oranges are excluded.) An expansion of the Yaounde Convention originally signed in 1963 with 18 African countries. Lome III was signed this year and expires in 1990.
Maghreb	Algeria, Morocco, and Tunisia	Duty-free access for raw materials and industrial products except textiles. For agricultural goods tariff concessions of 20 to 100 percent excluding products covered by the CAP. Signed in 1976, unlimited duration.
Mashreq	Egypt, Jordan, Syria, and Lebanon	Duty-free access for most industrial goods with the EC reserving the right to introduce import ceilings on certain products if necessary. Tariff concessions of 40 to 80 percent on most agricultural goods. MFA applied to Egypt. Signed in 1977, unlimited duration.
Generalized System of Preferences (GSP)	All LDCs (excluding Taiwan, which is not recognized by the EC)	The least preferential arrangement for LDCs. Offers duty-free access for industrial and agricultural goods; however, 150 products are subject to quotas. Renewed in 1981 for another 10-year period. Subject to revision in 1986, which may result in the removal of preferences for the NICs.

[redacted] 25X1

proposal, new exclusions would have the greatest impact on Hong Kong, South Korea, Brazil, and Singapore [redacted]

Despite the tightening in trade policy, the EC will seek solutions to most of its trade problems with LDCs in the proposed GATT multilateral trade negotiations (MTNs). Community members have both time and leverage on their side. The new EC trade restrictions applied now can be negotiated away later in the GATT in return for better EC access to LDC markets, particularly in services. A small group of LDCs, headed by Brazil and India, wants the talks confined to removing barriers to trade in goods alone. [redacted]

We believe one of the EC's major objectives in the GATT sessions will be to improve its access to LDC markets but will only offer reduced barriers on products where there is virtually no EC-based industry left to protect, such as black and white TVs. Replacement of EC nontariff barriers, such as quotas, with tariffs under GATT auspices—along with small concessions on the MFA—could also be used to induce developing countries' active participation in the new GATT round. In a July meeting of trade ministers from the developed nations, the EC Commissioner for Foreign Affairs, de Clerq, reaffirmed the Community's position that exclusion of services and reciprocal handling of concessions from negotiations would greatly reduce the capacity and willingness of developed countries to improve market access for LDC exports of manufactured products. Should the EC not achieve its goal in the MTN, it is likely that the Community will undertake bilateral trade negotiations and continue to selectively implement nontariff barriers. The admission of Spain and Portugal to the EC in January 1986 will continue to fuel protectionist sentiments, in any case, because many Iberian products compete directly with those of the LDCs. [redacted]

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Cuba: Seeking New Trade Ties to Latin America [redacted] 25X1

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Cuba recently has stepped up efforts—through increased trade ties—to build its regional influence, renew diplomatic ties to some of its neighboring countries, and open the doors to new markets in Latin America. While Havana has had some success politically, it is unlikely to achieve a significant trading presence in the region because of the need to reduce imports to save scarce hard currency, a limited export menu of mineral and agricultural products, and commitments to supply CEMA with a large proportion of the country's exports. Despite these efforts, Cuba's principal economic links will remain with the Soviet Bloc. [redacted]

Cuba's Motives

In our view, President Castro's attempts to renew or increase commercial ties in Latin America are motivated by a desire to reintegrate Cuba into regional political affairs as well as to alleviate domestic economic problems. Castro probably views the new more broadly based civilian governments in Latin America as an opportunity to reduce Cuba's regional isolation. Havana probably believes that an improved image would reduce the concerns of its neighbors that upgraded ties might jeopardize their relations with the United States.

[redacted]

Renewing Trade Ties

After President Sanguinetti repealed a 21-year-old decree prohibiting negotiations with Cuba, **Uruguay** and Cuba signed a bilateral trade agreement in July and resumed diplomatic relations on 17 October. In addition, [redacted] These renewed trade ties, however, probably will not produce any major increase in bilateral trade—to date, only one sale to Havana has been arranged. 25X1 Montevideo's exports compete with goods that Cuba imports from the USSR and China. [redacted]

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Colombia and Cuba have agreed in principle to open official commercial representations, [redacted] 25X1

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Castro presumably hopes that 25X1 commercial ties will lead to official diplomatic relations, but President Betancur is reluctant, [redacted] 25X1 25X1 based on past Cuban interference in 25X1 Colombia's affairs and the low level of trade and cultural relations that existed before the 1981 break. [redacted] 25X1

Brazil does not have formal diplomatic relations 25X1 with Cuba and conducts only minimal trade on an unofficial basis. [redacted] 25X1

Brazil is also a major sugar exporter and Havana lacks the foreign exchange to purchase Brazilian industrial goods. [redacted]

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Increasing Existing Trade

Argentina's exports to Cuba last year rose by nearly 75 percent over 1983 levels to $165 million as a result of a $200 million annual line of credit extended by Argentina to Cuba for 1984-86.

Cuban exports to Argentina, however, are negligible, in part because Argentina is a sugar exporter.

Mexico and Cuba are trying to expand bilateral trade and have set a short-term annual trade goal of $300 million in goods and services, according to the US Embassy in Mexico City. While Cuba's imports from Mexico have been on the rise, its exports to Mexico have been declining since 1980.[1] Limited demand for Cuba's exports—Mexico is largely self-sufficient in sugar—a modest cooling in political relations, consistent with President de la Madrid's generally moderate foreign policy, and both countries' need to restrain import spending will likely thwart their ambitious goal of tripling bilateral trade this year.

Mexico and Cuba, nonetheless, have taken some steps to boost commercial ties. Havana and Mexico City recently agreed to grant each other most-favored-nation status, lowering respective import duties by 25 to 75 percent. Mexico and Cuba also opened lines of credit amounting to $150 million and $20 million, respectively, to finance their bilateral trade. Agro-industrial, sugar, metal-mechanical, and pharmaceutical trade agreements have recently been signed.

Ecuador's President Febres-Cordero signed a bilateral trade agreement and discussed the potential for trade in agricultural goods during his April visit to Cuba. Although Febres-Cordero tried to play down the significance of the trip, Castro's image in

Cuba: Foreign Trade, 1984

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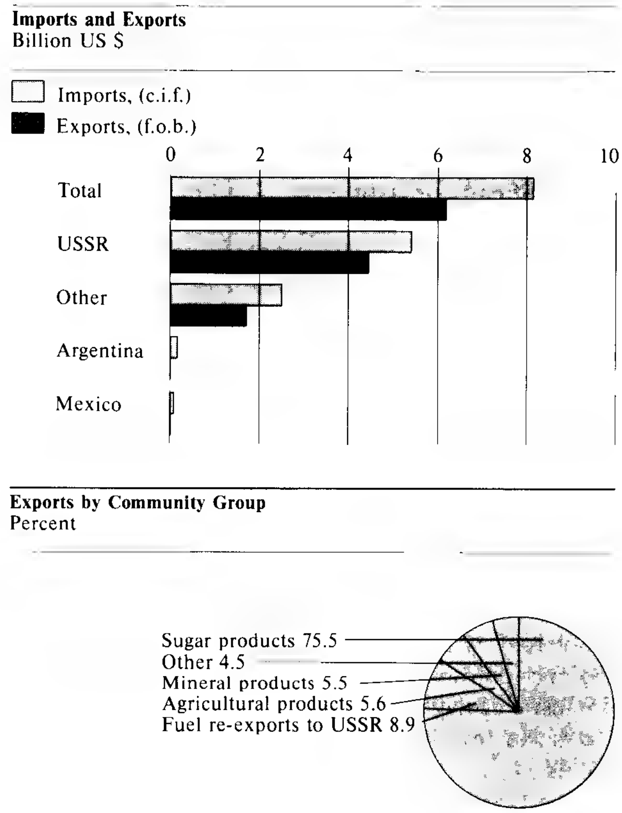

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Latin America probably was improved by the visit. Ecuador's Ambassador at Large, who led a business delegation to Cuba in March, signed a reciprocal line of credit agreement, amounting to an initial $3.6 million.

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[1] Cuba's exports to Mexico fell by over 95 percent to $12 million between 1980 and 1984 and continued to decline in the first half of 1985. Havana's imports from Mexico grew by over two and one-half times between 1980 and 1984 to $82 million and are still rising.

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[redacted]

Bolivia and Cuba created a commission to increase bilateral trade in May. [redacted] Currently, bilateral trade is minimal, largely Cuban pharmaceutical products for Bolivian tin. Cuba is also assisting Bolivia, one of Latin America's poorer countries, in technical training, health, mining, and agro-industry. Bolivia established an Embassy at the Charge level in Havana in the final weeks of the leftist Siles administration. New President Paz Estenssoro, however, distrusts the Castro regime and probably will rebuff any overtures to further normalize relations with Cuba. [redacted]

Outlook and Implications for the United States

Although Cuba has been successful in improving trade ties to several Latin American countries, we believe that trade levels are not likely to increase substantially in the near future. Havana's ability to export is constrained by its reliance on a few commodities—sugar, minerals, and citrus products—most of which are obligated for Communist countries and face limited demand in Latin America. At the same time, with continued tight finances Havana would find it difficult to boost imports from these countries. [redacted]

Despite the limitations Cuba faces in becoming a major Latin American trader, Castro may believe that it is important to establish a commercial presence in these Latin American nations. This presence will likely be used as a base to lobby for renewal of diplomatic relations or to exert influence in the future. [redacted]

We believe that Castro's efforts to increase ties to its Latin American neighbors will not change their attitudes toward Havana. Most Latin American leaders will continue to remain suspicious of Cuban interference in domestic affairs and support of insurgents. Nonetheless, Cuba's neighbors would welcome any increased hard currency earnings from trade with Havana and are being pushed by leftist interests to reestablish or increase ties to Cuba. Improving relations with Havana also provides a means for Latin American governments to assert their independence from the United States. We believe, however, that these countries would limit commercial or diplomatic ties to Cuba to avoid serious damage to their relations with the United States. [redacted]

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Briefs

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Energy

Spot Oil Market Trends

Spot oil prices remain firm despite increased OPEC production. Arab Light prices, which reached the official $28 per barrel mark for one day in early November, have remained within 15 cents of that level for the past week. Both North Sea Brent and Forties prices are above $29 per barrel, the highest levels this year. The continuing low level of Soviet exports to the West, record low inventories, and the start of a seasonal increase in oil demand have cushioned the impact of sharply higher production. The real test of market strength, however, probably will come over the next few weeks as the crude oil sold by the Saudis under product pricing arrangements reaches US and European markets. Over the longer term, most analysts continue to predict that prices will weaken by spring unless production is cut substantially. 25X1

Chinese Offshore Oil Lease Awards

China began awarding its second round of offshore oil leases on 8 November. A consortium of three Japanese companies was awarded the first contract for a 5,100-square-kilometer block located about 200 kilometers off Hong Kong. The consortium plans to begin exploration in January. As in previous deals, the consortium will bear the full cost of exploration and split any oilfield development costs with the Chinese. Beijing received bids from 23 foreign oil firms in 10 countries for the second round, and further awards should be announced shortly. The Chinese were forced to improve the terms because oil firms were threatening to pull out after little oil was discovered offshore in the first-round blocks.

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International Finance

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Mexican Financial Troubles

Mexico City, facing nearly $14 billion in budget overruns this year, is financing its deficit largely through domestic borrowing rather than cutting 25X1 spending. A 90-percent reserve requirement on banks imposed in July has assured government access to funds but has essentially cut off money for private-sector investment loans, according to the US Embassy. The domestic money supply has risen by 65 percent this year, according to the Embassy, adding to an inflation rate of at least 60 percent—the IMF target is 45 percent. President de la Madrid is likely to continue using stopgap measures rather than risk a popular backlash from new austerity measures. He appears to be counting on an IMF agreement to pave the way for new foreign loans to help finance the deficit next year. A growing sense of desperation may cause de la Madrid to

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agree to a strict IMF program that he knows Mexico cannot meet. While new borrowing may provide some temporary breathing room, as long as de la Madrid remains unwilling to cut the government deficit, Mexico will experience another year of tight domestic credit conditions, high inflation, and capital flight. 25X1

Slowdown in Argentine Stabilization Program

Despite well-publicized success on inflation—prices rose only 1.9 percent in October—Buenos Aires apparently has failed to comply with other binding IMF targets, according to the US Embassy. 25X1 The Fund is considering extending Argentina's standby agreement for three months, because the Central Bank deficit is still too large and import restrictions have not been eased. President Alfonsin has made little progress toward his goal of reducing the role of the public sector through deregulation and attracting increased foreign investment. Opposition from the bureaucracy and infighting among economic ministers have hampered Alfonsin's plans to secure more foreign participation in the oil and telecommunications industries. Argentine businessmen are complaining that the administration has neglected to carry out consistent, predictable trade policy. They fear that tight money and obligatory loans by business to the government may force several large firms into bankruptcy. The IMF may delay disbursements of new money, but Argentina has only narrowly missed its targets and probably will return to compliance. The President still appears committed to major reform, but further delays in putting controversial economic measures in place would be a sign that Alfonsin has decided to trade timely reform for short-term political gains. Such a choice would soon jeopardize Buenos Aires's IMF program and dim the prospects for long-term growth and political stability. 25X1

Panama Gains Financial Breathing Space

After months of delay, Panama signed an $850 million agreement with international commercial banks on 31 October. The deal provides a $60 million long-term loan and $80 million in trade credits and refinances $580 million in 1985-86 debt obligations. In addition, the banks promise to maintain 25X1 $130 million in deposits with local subsidiaries. While the first $20 million drawing is scheduled for mid-November, continued drawings are tied to economic policy changes that the new Delvalle government is unlikely to be able to implement. Even though Panamanian financial authorities are telling bankers that labor, industrial, and agricultural reforms recommended by the World Bank will be made soon, Delvalle—according to US Embassy reporting—has not formulated an economic program and, like his predecessor, almost certainly lacks the muscle to push through tough reforms. Meanwhile, Panama City is trying to meet reserve targets of the two-year IMF standby agreement signed last July by borrowing against its 40-percent equity in the transisthmian oil pipeline. 25X1

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Global and Regional Developments

Results of EUREKA Meeting

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Foreign and research ministers of the West European countries approved 10 research projects for EUREKA—most with the aim of developing specific commercial products—but they did not establish a funding plan at their meeting in West Germany last week. The projects, nine of which involve French firms, include research on high-speed computers, sophisticated lasers, microchips, data transmission, and pollution control. Meanwhile, industrialists expressed skepticism about EUREKA, and France remains the only country to pledge major funding. The ministers will meet again on EUREKA next May in London. Even with the selection of projects, EUREKA will not be viable until funding and management issues are settled. Because budgets are already tight, the West European governments are unlikely to come through next year with the necessary funds to stimulate industrial interest. They almost certainly will further define EUREKA's structure before the meeting in May and probably will grant the EC an organizing role on some projects. [redacted] 25X1

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France Rejoining European Fighter Project

[redacted]

President Mitterrand announced, following talks with Chancellor Kohl in Bonn last week, that France will rejoin the European Fighter Aircraft program. Paris expects its financial share in the project to be between 5 and 10 percent of the total—considerably less than the 40-percent share it insisted on earlier. At the same time, Mitterrand also announced that he invited other European governments to join France's own new fighter project—the Rafale. Mitterrand is touting the decision as an indication of his personal commitment to European cooperation. In practical terms, it is probably more to provide access for French industry to other European technology and markets. The specifics of France's participation remain to be worked out, however, and its continuing commitment to the Rafale probably will keep French financial and industrial involvement at token levels. This decision may reduce R&D costs for both aircraft and buy access to the EFA market for French component manufacturers. [redacted] 25X1

Pressure on Japan For Airbus Purchase

[redacted]

West European leaders, particularly the French, are putting pressure on Tokyo and All Nippon Airways to pick Airbus over Boeing in a deal that could total $1.5 billion. According to the US Embassy in Tokyo, EC officials attending the Japan-EC ministerial meeting in Tokyo next Monday are likely to push the issue. All Nippon Airways has decided to delay a decision at least until after the meeting and perhaps for as long as two months. The delay may be designed to wring greater concessions out of both Airbus and Boeing and allow Prime Minister Nakasone time to seek a solution that will not disrupt relations with the United States or jeopardize the atmospherics for the Economic Summit in Tokyo next May. Nakasone may decide to support the purchase of aircraft from both [redacted]

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National Developments

Developed Countries

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Japanese Purchase of US Equipment

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Japan Capturing Industrial Laser Market

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Japan's New Space Use Organization

[redacted]

Japanese industrial firms will establish the Space Environment Utilization Center in December to coordinate Japanese efforts on the commercial uses of space. The center's initial funding will come from private donations totaling $250,000, and contributions are expected to rise to $2.2 million in two years. The center will coordinate Japanese commercial and industrial experiments flown on the US space shuttle and other spacecraft as well as Japanese uses of the US space station. According to the Japanese press, both MITI and the Science and Technology Agency (STA) support the new group. We believe industry views it as one way to resolve the developing feud between the two agencies. MITI has challenged STA's primacy in space policy—which includes responsibility for space-related R&D for launch vehicles and spacecraft—by claiming authority to oversee any Japanese commercial ventures, whether on earth or in space [redacted]

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Forecast of Broader West German Growth

Recent forecasts—including the joint forecast of West Germany's five major economic research institutes and our own econometric model of the West German economy—agree that West German economic growth next year will not only increase but also be broader based. In particular, personal consumption and construction are expected to revive combining with the export surge that has been the mainstay of growth over the past two years. The consensus foresees 3-percent real growth in 1986, up from 2.2 to 2.5 percent this year. An important projection for the Kohl government, as the January 1987 election approaches, is that the unemployment rate should edge down 0.2 to 0.3 percentage points—the first decline since 1979—to just over 9 percent. Despite slower growth in real exports, next year's trade surplus probably will surpass even this year's expected record of $30 billion. West German officials are concerned that the rapidly mounting surplus will intensify calls from abroad to boost the economy but will cite the forecasts as evidence that stimulative measures are unnecessary. 25X1

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London Pushing To Speed Privatization

London is seeking to offset overruns in public spending and to deliver promised tax cuts by doubling its projected sales of nationalized companies next year. The Treasury reportedly wants to increase the privatization program to roughly $5.8 billion in 1986, compared with $3.2 billion originally planned. Since the Treasury records privatization as negative public spending rather than revenue, increased sales would enable the government to "meet" its planned spending totals for the 1986-87 financial year, despite budget overruns in a number of departments. The Queen's speech opening Parliament last week revealed plans to introduce legislation to privatize four major entities—British Gas Corporation, the Atomic Energy Authority, the British Airports Authority, and the Royal Naval Dockyards—but did not specify government estimates of the proceeds from the sales. The bill probably will obtain Parliamentary approval, despite misgivings about selling off state assets as a short-term way of raising money

Belgian Labor Proposes Jobs Program

Belgium's Catholic and Socialist labor federations are not likely to receive much support from the Marten's government for their demands to increase employment, restore purchasing power, and safeguard social security. The Catholic federation's plan includes government stimulation of the economy, an active employment policy, generalization of the 38-hour workweek, maintaining full social security benefits, and restoring wage indexation based on the cost of living. It also recommends a European-wide program to cut unemployment in half by 1990 through fiscal and monetary expansion, job-creating investments by employers, and moderation of union wage demands. The Socialist memo largely echoed that of the Catholic unions, but with an even stronger call for cancellation of the government's decision to suspend the 1986 indexation of wages and social benefits. They are also calling for renewed cooperation between the two federations to present a united front to the government. In response, Prime Minister Martens has said his new government will continue to implement deficit reduction measures, which are at odds with labor's proposals. 25X1

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Portuguese Current Account Deficit Improves

[redacted]

Although it has eroded outgoing Prime Minister Soares' popularity, Portugal's painful austerity program has reduced the current account deficit to $259 million in the first half of 1985, from $640 million a year earlier. The improvement reflects a 40-percent decline in the trade deficit. Sluggish domestic demand contributed to a 10-percent decrease in the dollar value of imports while a favorable competitive position—particularly in textiles and apparel—helped boost exports by 3 percent. The services deficit also improved—partly a result of increased tourism—falling 12 percent from the first half of 1984. These developments more than offset the 17-percent drop in worker remittances. Lisbon projects a yearend deficit of only $150 million, a 70-percent decline from the 1984 level. This would be a welcome prospect in view of the probable short-term effects of Portugal's forthcoming EC accession on the external account as the economy opens to European competition. [redacted]

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Less Developed Countries

Impending Layoffs in Suriname

[redacted]

Plans by two large Surinamese companies to implement large-scale layoffs present a serious economic dilemma to the Bouterse military regime. Suralco, a US-owned aluminum company and Suriname's largest foreign exchange earner, has announced plans to eliminate at least 500 jobs, while the Kersten Company, a local retailing conglomerate, intends to lay off over 800 workers. The government—which, by law, must approve any layoffs—probably will try to strike a compromise between concerns for the precarious financial condition of both companies and job losses. Higher unemployment, however—estimated by the Embassy to be 30 percent currently—increases the prospect for labor unrest. Moreover, if these companies successfully trim their work forces, other firms are likely to also press for similar layoffs. [redacted]

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Soviet Shortage of Hard Currency

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The USSR has asked that all Western suppliers of large-diameter pipe renegotiate contracts to substitute long-term credits for cash on deliveries scheduled for fall 1985 through spring 1986. These requests resulted from a temporary suspension of fund allocations because of hard currency problems plus the need to make down payments on large projects. Suppliers are delaying shipments until negotiations are resolved. [redacted] the USSR has not completed negotiations on contracts generally concluded at this time of year. Western statistics show that the Soviet debt to Western banks has risen by about $3 billion since December, while assets in the West have fallen by more than $2 billion. Moscow appears to be treating its recent decline in hard currency earnings—primarily from reduced oil exports—as a temporary problem, financing important imports and reducing or postponing less essential products. Negotiations for large, expensive projects with Western firms for the 1986-90 plan period seem untouched thus far [redacted]

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Tougher Soviet Construction Materials Standards

[redacted]

Tougher quality standards demanded by the Soviet leadership are having an impact on the construction materials industry. In September a branch of the Noril'sk combine—the Soviet's largest nonferrous metals producer—reportedly refused to accept the products of the combine's concrete plant because they failed to meet standards set by the State Committee of Construction Affairs. This action—taken despite a grace period for accepting lower quality materials until mid-1986—could lead to a temporary halt of all construction at the combine. The plant expects to have its products up to standard upon completion of a new crushing facility next year. Enforcement of higher quality standards is another indication of the emphasis Gorbachev is putting on improving efficiency of construction in his aggressive modernization program. It follows a call in early September for the reevaluation of all construction projects in the nonferrous metallurgy industry for the 1986-90 period to ensure they are consistent with plans for the introduction of newer, more modern production equipment. [redacted] 25X1

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Vietnam's Proposed Indonesian Rice Purchase

[redacted]

Vietnam has asked Indonesia for 200,000 to 300,000 metric tons of rice to make up for typhoon damage to its crop [redacted] Hanoi is seeking two- to three-year credit terms for its purchases. The proposed sale follows the recent signing of a bilateral trade agreement. It would improve ties between Jakarta and Hanoi and offer Jakarta a means of disposing of surplus rice at a good price. Indonesia, nonetheless, is unlikely to supply the full amount. Jakarta's ASEAN partners officially oppose large-scale trade with Hanoi because of Vietnam's occupation of Cambodia. Jakarta almost certainly will be hesitant to supply large credits since Vietnam is already $635 million in arrears on its hard currency debt of $1.6 billion, with little prospect of repayment soon. [redacted]

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